TECHNICAL REPORT

Poverty Reduction in Indonesia, 1965 to 1997

A Country Case Study

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SUBMITTED TO
USAID/Washington, D.C.

SUBMITTED BY
Nathan Associates Inc.

SUBMITTED UNDER
Contract No. PCE-I-00-00-00013-00

November 29, 2002

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1. Introduction

From 1965 to 1997, Indonesia experienced one of the most rapid declines in poverty of any country in the world. The percentage of the population living in poverty fell from 50.6 percent in 1970 to 11.3 percent in 1996 and the number of people living in poverty fell from 60 million to 22.5 million.[1] This dramatic decline occurred even though poverty reduction was not a central goal of the Indonesian government. Among experts on Indonesia, three factors are considered critical to the country's success with poverty reduction. First, macroeconomic policy was extremely well managed for most of the period, combining generally market-friendly policies with tight controls on government spending. Second, the government invested heavily in rural infrastructure and agricultural technology, dramatically increasing agricultural productivity and increasing rural incomes. Third, the government established policies that promoted exports of labor-intensive manufactures, creating millions of jobs for relatively low-skill workers.

In this paper we analyze Indonesia's experience with poverty reduction from 1965 to 1997. We describe the trends in poverty and income distribution, describe major aspects of government policy and economic growth during the period, review the literature on the causes of Indonesian poverty reduction, and describe the poverty experience from 1998 to 2001, when the country went through a political and economic cataclysm.

[1] This is a 78 percent reduction in the percentage of people in poverty, and a 62.5 percent reduction in the number of people living in poverty over a period of 26 years. This is much faster poverty reduction than the international goal of halving the percentage of people in poverty in 25 years.

2. Trends in Poverty, 1965 to 1997

From the mid-1960s until 1997, Indonesia made rapid progress in reducing poverty. Using the very low poverty line adopted by the Indonesian statistical agency, BPS, the share of the population in poverty fell from 50.6 percent in 1970 to 11.3 percent in 1996. Survey estimates are not available for 1965, but that was a year of economic chaos and political instability, and poverty would certainly have been higher than in 1970. The trend since 1970 is presented in Table 1.

Table 1
Poverty in Indonesia, 1970–1996

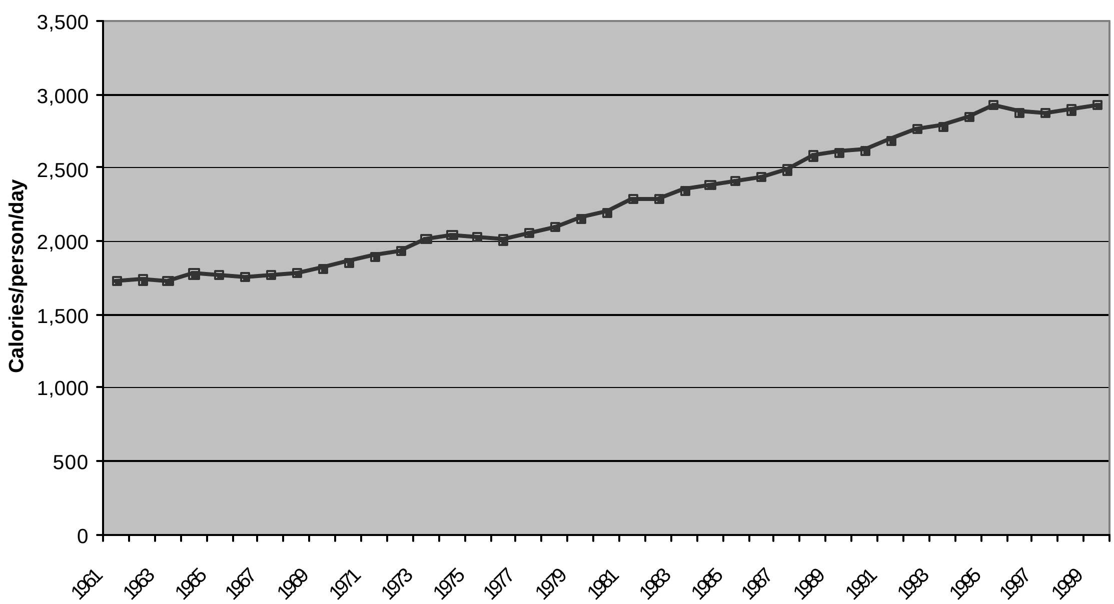
Year	Percent in Poverty			Numbers in Poverty		
	Urban	Rural	Total	Urban	Rural	Total
1970	53.6	38.7	50.6			60.0
1976	38.8	40.4	40.1	10.0	44.2	54.2
1978	30.8	33.4	33.3	8.3	38.9	47.2
1980	29	28.4	28.6	9.5	32.8	42.3
1981	28.1	26.5	26.9	9.3	31.3	40.6
1984	23.1	21.2	21.6	9.3	25.7	35.0
1987	20.1	16.4	17.4	9.7	20.3	30.0
1990	16.8	14.3	15.1	9.4	17.8	27.2
1993	13.5	13.8	13.5	8.7	17.2	25.9
1996	9.7	12.3	11.3	7.2	15.3	22.5

Source: Booth (2000, p. 78).

The principal evidence for the trend in Indonesian poverty comes from regular BPS surveys, called Susenas, of household expenditures. The Susenas surveys of household expenditures are quite large (around 65,000 respondents), and have been carried out using the same general methodology since the 1960s (recently at three-year intervals). They provide information on both the numbers and percent of the population in poverty and on household expenditure distribution. The latter is used as a proxy for income distribution.

The trend in poverty based on household expenditures is consistent with data on other indicators of well being. The FAO reports a steady and sharp increase in food intake over the period.[2] Average caloric intake rose from 1,770 calories per person per day in 1965 to 1967 to 2,900 calories per person per day in 1997 to 1999 (see Figure 1). Caloric intake tends to be much more equally distributed among the population than income, and an average intake above 2,600 is regarded as sufficient to avoid large-scale undernutrition. This aggregate trend and numerous studies at the micro level confirm a significant increase in the adequacy of the diet of poor Indonesians.

Figure 1
Average Caloric Intake in Indonesia, 1961–1999



SOURCE: FAO

Trends in life expectancy and infant mortality also support the claim that poverty has fallen substantially. The United Nations estimates that life expectancy in Indonesia rose from 46.0 years in 1965 to 1970 to 65.1 years in 1995 to 2000—a nearly 20-year increase. Over the same period, infant mortality fell by two-thirds, from 144 per thousand births to 48. Infant mortality tends to be highest among the poorest, so this change also supports the view that poverty has been substantially reduced over the period.

Expenditure distribution across households remained quite stable over the period. Table 2 shows the trend in the Gini coefficient over the period. The Gini coefficient is the most widely used measure of income inequality. A coefficient of zero means perfect equality of incomes across households; a coefficient of one means one household has all the income. Coefficients below 0.4 indicate low or moderate income inequality; coefficients above 0.5 indicate high inequality. Because

[2] Van der Eng (2000) provides alternative estimates of the trend in Indonesian food intake over a much longer period. His estimates for the period discussed here are generally consistent with the FAO estimates, though he reports a slightly larger increase in per capita caloric intake over the period.

the Gini coefficient for income will be higher than that for expenditure, this rule of thumb may overstate the egalitarianism of Indonesia. Nevertheless, its income distribution is surely among the more equal for developing countries.

For Indonesia, the Gini coefficient moved from .35 in 1964/65 to .36 in 1996, having fluctuated in between .32 and .38 over the entire period. In sum, the expenditure distribution was relatively equal and quite stable over the period. Such measurements, however, are subject to error. One expert on such surveys, Martin Ravallion of the World Bank, recently suggested that Gini coefficient measurement should be seen as subject to an error of ±.03. In other words, an estimate of .35 should be considered likely to lie between .32 and .38. All of the estimates for the national Gini coefficient lie in this range. If this error estimate is correct, then the Indonesian income distribution should be considered to have been stable over the entire period. These data show a very stable and broad-based development path. And the aggregate trends suggest that all socioeconomic groups gained about equally, in percentage terms, in the growth over the entire period.

Table 2
Gini Coefficients for Indonesia

Year	Percent in Poverty		
	Urban	Rural	Total
1964–1965	0.34	0.35	0.35
1969–1970	0.33	0.34	0.35
1976	0.35	0.31	0.34
1978	0.38	0.34	0.38
1980	0.36	0.31	0.34
1981	0.33	0.29	0.33
1984	0.32	0.28	0.33
1987	0.32	0.26	0.32
1990	0.34	0.25	0.32
1993	0.33	0.26	0.34
1996	0.36	0.27	0.36

Note: Data is for per capita household expenditures
SOURCE: BPS Statistical Yearbooks, reported in Booth 2000

While the actual trend in poverty and income distribution was extremely encouraging to anyone concerned about extreme poverty or income distribution, it is rarely reflected in the development literature from 1965 to 1997. Instead, much of the literature expressed a continual concern about perceived trends in increasing inequality and increasing poverty among the poor—or significant groups of the poorest. The literature often reflects a “Chicken Little” perspective (i.e., the sky is falling) about possible trends in inequality.

Examining trends of the 1970s, Papanek (1980) comments: “But it appears that income distribution deteriorated throughout the 1970s, and the crucial question for the future remains: ‘Will Indonesia use the limited but significant resources available to provide jobs at a rate sufficient to keep the urban proletariat from swelling to unmanageable proportions" (65). In the same volume, Dapice is even more pessimistic about the past and the future:

> The 1970s was a period of rapid, even violent, structural change in the Indonesian economy. Progress was highly uneven, leaving behind many who were not well-equipped to take advantage of new jobs, technologies, and opportunities. There is little doubt about the considerable growth in average consumption, or the concentration of that growth in the upper fifth (or so) of the population. The major uncertainties are what degree of income inequality is acceptable to society, and what policies hold out realistic hope of continuing growth and also of doing more for the groups who have been excluded so far. It is resolving those uncertainties, rather than refining the estimates of income distribution, that deserve high priority at this time. (80)

Booth and McCawley (1981) expressed a similar concern that improvements in agricultural technology were worsening the condition of poor farmers and landless people. Among other things, they worried that replacement of harvesting knives by sickles and hand-pounding of rice by milling were worsening conditions for the poorest. They write of "evidence of large-scale landlessness and labour displacement through technical change and possibly declining real wages for at least some categories of agricultural labour…."(94)

They go on to express great skepticism about the government policy aimed at promoting exports of manufactures as an important contributor to poverty reduction in Indonesia:

> In the wake of the success achieved through export-oriented manufacturing growth in such countries as South Korea and Taiwan, some have advocated a similar strategy for Indonesia. But for many reasons, Indonesia is not South Korea or Taiwan. One wonders how realistic it is to expect that substantial employment can be created in labour-intensive export sectors in Indonesia, even if the traditional agricultural exports are taken into account. (319)

By the late 1990s, Booth (2000) had changed her view of this period, writing that

> …the growth in agricultural production that occurred in the 1970s and early 1980s, in considerable part due to the successful dissemination of new production technologies in the foodcrop sector, created new employment opportunities in production, processing, and marketing. Indonesian agriculture remained very unmechanised and labour intensive compared with agriculture in most other parts of Asia well into the 1980s, because the small average size of holdings made purchase of agricultural machinery uneconomic for most farmers. (81)

Booth (1998) also rewrites history regarding the shift to export promotion, moving the shift in policy from the late 1970s into the 1980s (and suggesting that they were late in recognizing its potential), and failing to admit that she was among the "many" who were skeptical of export promotion because they believed that it would enrich the few at the expense of the many:

> It was not until the 1980s that the Indonesian government began to view broad-based export growth as a means of achieving both faster economic development and improved economic welfare, and this change in view was largely due to the powerful demonstration effect from the successful export economies of Northeast Asia, and from ASEAN neighbors such as Thailand and Malaysia. But even then, there were many who viewed export-led growth as an essentially inegalitarian strategy, which would enrich a few (mainly Chinese) entrepreneurs while trapping most of the labour force in poorly paid, unskilled jobs. (330-331)

In sum, what appears in retrospect as a smooth, broad-based growth process that benefited all sectors of society equally in percentage terms was one that, at the time, raised fears about distributional consequences. Had the Indonesian government deviated from the course it actually followed in order to pay greater attention to poverty, it is not at all clear that Indonesia's poor would have been better off. Indeed, since Indonesia's performance on poverty reduction outstripped that of all the countries that gave greater centrality to poverty reduction (such as India, Sri Lanka, and China in the 1960-1980 period), the contrary seems more probable. Had the government followed the prescriptions of those pressing for direct action for poverty reduction, it seems likely that poverty would have been higher in 1997 than it was, and that Indonesia as a whole would also have been poorer.

3. Indonesian Economic Trends, 1965 to 1997

The impressive performance in reducing poverty described in the previous section would have been considered highly improbable by anyone looking that Indonesia in 1965. A leading economic development textbook from the mid-1960s describes Indonesia as follows:

> Indonesia must surely be accounted the number one economic failure among the major underdeveloped countries. No other large and populous country presents the same stark picture of prolonged economic stagnation, persevering throughout centuries of colonial rule and continuing throughout a decade and a half of independence. Stagnation—in the form of virtually constant levels of per capita income or an unchanging structure of employment and production or both—is certainly not unknown among underdeveloped countries; but the Indonesian experience, in which a whole series of concepts of economic organization, first in a colony and then in an independent nation, failed to bring significant or lasting improvements in levels of living at any time, seems to be unique (Higgins 1968, 678).

Some saw Indonesia in more apocalyptic terms. In 1965, Java's 68 million people (a population density of more than 500 people per square kilometer) conjured a Malthusian trap—an "agricultural involution" whereby increased labor applied to rice production yielded steadily diminishing returns (Geertz 1963). Java was seen as having no means for achieving the capacity to feed itself or to avoid eventual mass starvation (Keyfitz 1965).

Higgins, Geertz, and Keyfitz were proved dramatically wrong during the next three decades. Economic stabilization after 1965 brought inflation down from three-digit levels and the country began a period of rapid and sustained economic growth. The average growth rate of per capita income for the entire period from 1965 to1997 was 4.4 percent, meaning that per capita income quadrupled. Population nearly doubled, so in real terms overall GDP grew nearly eightfold.

The growth of Indonesia's agricultural sector was just as impressive. Rather than showing diminishing returns, rice productivity grew dramatically, with the average yield rising from 1.9 tons/hectare to 4.4 tons, surpassing yields among Asian neighbors. Indonesia, once the world's largest rice importer, became an occasional exporter. Overpopulation in Java—for which "transmigration" projects to move people to less populated parts of the archipelago were seen by some as the only solution—receded as an issue as employment and incomes rose rapidly on the island.

Indonesia emerged from a period of economic chaos and political turmoil in 1965. One man led the political system from 1965 to 1998, and provided the country with a stable and coherent policy. Economic policy was driven by two principles. On the fiscal side, the government maintained the principle of no domestic financing of government deficit spending. This "no deficit" policy eliminated a major source of inflationary finance. Inflation, quickly brought down from the hyperinflation of 1965, has stayed below 10 percent in most years since the early 1980s. The second principle was convertibility of the rupiah, which has been in effect since 1971. Convertibility forced the Indonesian central bank to maintain private sector confidence in its monetary management. Any loss of confidence would quickly lead to a run on the currency. Without ever resorting to an IMF standby agreement, Indonesia has managed its development by carefully managing its economy, by holding adequate foreign exchange reserves, and by being willing to adjust immediately to external shocks.

Indonesia's large deposits of oil and natural gas dramatically boosted the country's export earnings in the 1970s. When oil prices began to fall in the early 1980s, Indonesia was one of the few major exporters to avoid a significant decline. Other exporters—Mexico, Nigeria, Iraq, Iran, Algeria, Ecuador, and Venezuela—are still making adjustments to resume economic growth.

Indonesian policy differed in at least two important ways from that of other exporters. First, the government drastically cut spending to match the declines in oil revenue that followed price breaks in 1981 and 1985. These cuts were dramatic, falling most heavily on the investment budget, but big budget cuts proved less harmful than maintaining spending while the fiscal deficit grew, which is what most oil exporters did. Second, after oil prices rose in 1973 the governments of oil-exporting countries felt political pressure to keep domestic petroleum prices below world levels. Indonesia at first used price controls, but then placed the subsidy on-budget so that the cost of the subsidy had to be taken into account in the budget process. This created pressure to raise domestic oil prices to make more of the budget available for high-priority spending programs. By 1993, Indonesia's oil prices had risen approximately to world levels. Indonesia seems to be the only major oil exporter to have achieved this, and explicit budgeting of the subsidy is why.

As oil prices began to decline, Indonesia began to promote other exports, particularly manufactures. In 1980, oil and natural gas exports represented 72 percent of exports; in 1997, manufactures represented 73 percent of total exports and oil and gas only 10 percent. Manufactured exports grew from $533 million in 1980 to $30 billion by 1997. Indonesia had emerged as a major exporter of manufactures on world markets, mostly of labor-intensive products.

4. Explanations for Indonesia's Success

What factors were most responsible for Indonesia's success in poverty reduction? Any complex enterprise can be described in a variety of ways. A country's economic and development policies are especially complex, as they include numerous activities that are mutually inconsistent and that differ widely from policy statements. Consequently, describing a government's policies as pro-poor, pro-market, or pro-anything will give rise to defensible counterclaims that the policies are quite different. For example, Indonesia is usually claimed to have followed market-friendly policies. But as Fane (1999) points out with great specificity, Indonesian economic policy endorsed many, and many large, variations from reliance on market forces. But clearly, as discussed in the previous section, the general economic policy environment was very supportive of rapid economic growth.

Indonesia has been particularly well studied by development experts. Hill (2000), Prawiro (1998), Booth (1998 and 2000), and Bresnan (1994) provide broad descriptions and analyses of all or most of the period under study. The World Bank's 1993 "Asia Miracle" study also examined Indonesia in the context of the other rapid-growth Asian economies. In broad terms, observers agree with the conclusions of the Asia Miracle study. These are that conservative monetary and fiscal management, market-friendly sector policies—including an outward-oriented trade posture—and emphasis on human resource development through mass education and public health measures were important to rapid and broad-based economic growth.

Among Indonesia-only studies consensus on the causes of the rapid poverty reduction exists on two points. First, overall economic management contributed in a major way. Policies and management were generally excellent, relying heavily on the use of market forces to promote development, and responsive to evolving circumstances. This provided an environment in which all sectors of the economy, and all income classes, could benefit. Second, promotion of rice technology and rural investment were very important in the first two decades and promotion of manufactured exports was important in the third decade. The investment in rural areas—where the bulk of the poor were in 1965—helped sharply raise production and incomes. Later, the rapid growth of manufacturing employment, particularly for low-skill workers, provided rising incomes for the burgeoning urban population. Timmer (1996) provides a succinct account of the message from the first edition of Hill's book: "The basic story [of Indonesia's 'remarkable' record on poverty alleviation] involves macroeconomic stability, successful management of natural resource booms, avoidance of the worst features of 'Dutch disease,[3]' and a policy shift to manufactured exports after two decades of rural-oriented policies solved the country's food problem." (114)

Solving the Food Problem

The mechanism by which the country's food problem was addressed is of particular importance. Thorbecke and van der Pluijm's (1993) study of Indonesian agriculture over the period concludes that economic policies were more important than services to farmers in promoting agriculture:

> Indonesia's success in agriculture can to a large extent be attributed to pragmatic macro-economic policies, which have created a favorable environment through which farmers have access to subsidized inputs and benefit from relatively stable prices. These general macro policies have been of even greater importance than the operation of agricultural service institutions, such as the extension service, BIMAS credit, village cooperatives and the delivery of packages to the farmers. (280)

Bresnan (1993) supports this view of a rural bias in Indonesian government policy, adding further that it "was highly progressive through the 1970s and 1980s; the major benefits went to small-holding families, especially in Java's rice-growing regions, which also held many of the nation's poor." He goes on to claim that this was possible only because Indonesian governance was undemocratic:

> It is difficult to imagine that a political regime in which policy-making was shared with a popularly elected legislature would have been able to sustain this strong rural bias for more than two decades. Given the distribution of secondary and higher education in Indonesia, such a legislature in recent decades would have been dominated by elite urban interests….The authoritarian nature of the Soeharto regime enabled it to pursue this rural vision without urban hindrance. (289)

Two aspects of the rural development package, BIMAS credit and government grants for regional development, deserve elaboration. The BIMAS credit program was regarded as largely unsuccessful (Sjahrir 1986, 119). Under the program, the Bank Rakyat Indonesia (BRI) established approximately 3,600 village offices, or *unit desas*, to channel subsidized credit to rice farmers. Like subsidized agricultural credit programs elsewhere, BIMAS mistargeted to larger farmers and suffered poor repayment rates and financial loss. With financial sector reform in 1983, the unit desa system was given the option of achieving profitability or closing down. The unit desas were permitted to charge market rates of interest on loans (no longer linked to rice production) and to pay market interest rates for savings. With strong leadership the BRI unit desa program emerged as a mass provider of financial services to low-income people in rural areas in Indonesia. By 1996 it

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[3] "Dutch Disease" refers to the tendency for exports of a natural resource such as oil to cause an appreciation of the exchange rate that makes the country's other products uncompetitive on world markets.

was highly profitable, with a portfolio of 2.5 million small loans averaging $684, and 16 million savings accounts averaging $187, but aggregating to $3 billion.[4] In contrast to the subsidized BIMAS program, this institution was contributing significantly to the development of micro and small business in rural Indonesia, and providing poor people with access to financial services.

Rural development grants provided local governments in rural areas with funding for infrastructure. While they were provided to rural areas, which were generally poor—like most of Indonesia—they were not targeted to the poor. As Booth (2000) writes:

> It is certainly true that the oil boom did see an increase in government expenditure, although little of this increase was explicitly targeted to the poor. Even the regional development grants, or Inpres grants as they came to be known, were not specifically designed to alleviate poverty, but rather to give provincial and subprovincial levels of government more scope to carry out much needed infrastructure rehabilitation and development. (80)

Indonesian Structural Adjustment

While Indonesia never had a period of negative economic growth over the period studied, per capita growth was only slightly above zero in two years—1982 and 1986. These were years of "structural adjustment," when the fall in export earnings and government revenues led to sharp cuts in government spending. Government spending was cut from an oil-wealth bloated 29.1 percent of GDP in 1981 to 21.3 percent in 1982.[5] The 1986 adjustment was also sharp, with government spending cut by 9 percent from the previous year. Ravallion and Huppi (1989) studied the impact of this period of structural adjustment on poverty and income distribution, using data from the 1984 and 1987 Susenas surveys. They found that there was unambiguous reduction in poverty over the period, as well as increases in real income over the entire income distribution. Booth (1998) offers one explanation for why the poor did not suffer from the period of fiscal austerity:

> During the period of budget austerity, the government cut back on expenditures which did not directly affect the poor; as budgetary subsidies on staple foods and non-food items such as fuel were relatively modest, their reduction did not lead to sudden, large increases in the cost of living for the poorer groups in society, as happened with structural adjustment programmes in other parts of the world. (131)

In sum, the poor did not suffer from fiscal austerity because they had not been favored by subsidies earlier.

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[4] The description of the *unit desa* program is from Robinson 2001.

[5] Data from Bevan, et al. 1999, 153. Comparable figures are not provided for 1985/86 because (despite its publication date) the data in this volume end with 1985.

Poverty Reduction as an Indonesian Development Goal

Clearly, Indonesia was more successful in reducing poverty than all but a handful of countries during the 1965 to 1997 period. Was poverty reduction an explicit goal of government policy or a byproduct of or intermediate step toward another goal? The literature provides two complementary perspectives on this question, both suggesting that economic growth and not poverty reduction was the central focus of Indonesia's development strategy.

Booth (1998) concludes that the principal motivation was not poverty-centered, but much more concerned with national self-preservation through economic growth:

> The main reason why economic growth has been broadly supported as a policy goal since 1966 is that all sections of the policy-making elite in Indonesia realize that rapid economic growth is occurring throughout the Asian region and that if Indonesia falls behind it will become more vulnerable to external threat and to internal insurrections. Economic growth is thus desired not as an end in itself, but as the means of achieving the pre-eminent policy objective of preserving the territorial integrity of the nation. This in itself is not surprising; a similar view of economic growth as an instrument of national self-preservation, was influential in other authoritarian developmental states, from Meiji Japan to Franco's Spain and South Korea under Park Chung Hee. But the history of these three countries would suggest that the forces of economic growth, once unleashed, will inevitably lead to demands for a stronger legal and constitutional framework which guarantees a broad range of civil liberties, including a strong regime of property rights. In Indonesia, too, it is inevitable that economic growth will create such demands, which the political system will have to accommodate. (336)

Hill (2000) offers another perspective, making clear that poverty reduction was not an overarching goal:

> The New Order [Soeharto] regime has been criticized for paying insufficient attention to poverty and inequality. These criticisms are justified in a number of areas. There has never been a serious attempt to introduce a progressive structure of taxation. The politically powerful receive all manner of special privileges and perquisites, some quite blatant in nature. The poor, lacking any political power, have sometimes been treated shamelessly, such as in the relocation of urban squatters, or the eviction of tenant farmers from their land.

He goes on to identify some areas—rice, basic education, infrastructure—that have benefited the poor. But his commentary makes clear that governments offer a mixed bag of policies, some pointing in one direction and some in another.

5. The Crisis of 1997–1998 and its Aftermath

In July 1997, Thailand was forced to devalue its currency, setting off what came to be called the Asian financial crisis. Indonesia initially fared better than its neighbors because, consistent with its policy, it allowed the rupiah to depreciate rather than exhausting its foreign exchange reserves before being forced to do so. Ultimately, however, the crisis in Indonesia was far more severe than in any other Asian country because the financial crisis quickly became a crisis of the regime. Discontent about the lack of democracy had been growing for years and was worsened during the mid-1990s by the growing public role of the President's children in amassing great wealth through influence peddling and acquisition of monopolies. The Soeharto government fell in early 1998, bringing in a period of political instability. A further complication during the crisis was a severe *El Niño*-induced drought at the end of 1997.

The combination of these factors led to a 13 percent decline in GDP in 1998. News reporters saw "Indonesia's economy in ruins and famine looming in some areas,"[6] and that "for tens of millions of people a whole generation's worth of progress has suddenly vaporized."[7] The crisis caused great suffering for many—though the correlation between a family's initial income and the amount of pain it endured when economic organizations, law and order, and other institutions collapsed is likely to have been very limited.

Fortunately, these concerns proved to be exaggerated. Public order was restored, and democratic institutions replaced authoritarian government. Most of the gains during the three decades of growth were maintained. Incomes fell, but only to the level of 1994. After a spike in 1998—the magnitude of which is subject to widely different estimates—poverty returned to the relatively low levels of the early 1990s. The response of the international community and the Indonesian government to economic collapse was relatively rapid. Before the crisis, Indonesia had no institutionalized safety nets, but a number of safety net programs were put in place afterwards, including programs that provided subsidized rice, mainly to poor people, and incentives to keep children in school to assuage fears that the children of poor families would desert the schools en masse.

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[6] *Washington Post*, July 17, 1998: 1.
[7] Stephen S. Rosenfeld, *Washington Post*, July 17, 1998: 21.

Considerable survey research has provided a broad picture of the impact of the crisis on poor Indonesians. While the initial effort to provide assistance focused on the poorest, subsequent research suggested that these were not the hardest-hit by the financial crisis. Indeed, some of the rural poor experienced rising real incomes as the price of food rose. (Bresciani, et al. 2002, conclude that all five quintiles of rural households experienced real increases in income over the period of the crisis). In general, urban workers were more affected than rural workers. The type of suffering by masses of unemployed urban workers facing rising food prices led some to suggest that the response of governments and donors to such crises give more attention to “safety ropes” to keep the well-being of affected people from falling more than a certain distance, and less to “safety nets” focused only on the poorest, whether they have been adversely impacted or not. (Suryahadi, Sumarto, and Pritchett, 2001).

After the crisis, the Gini coefficient fell from .36 in 1996 to .31 in 1999.[8] Overall, this is lower than any of the Gini coefficients recorded during the 1965-1997 period, and the only estimate that falls outside the .35±.03 range. In essence, better-off Indonesians were more affected by the crisis, on average, than poorer Indonesians. But it suggests that greater income or expenditure inequality is not an end in itself. Few Indonesians might think that the calamity of 1997/98 was an acceptable price to pay for a more equal income distribution.

One aspect of the economic crisis that deserves more research is the *unit desa* microfinance program of Bank Rakyat Indonesia mentioned earlier. BRI’s large corporate clients suffered massive bankruptcies, and most of its portfolio had to be written off. Its medium and small business portfolio suffered smaller losses, but still required significant write-offs, and 20 percent of the remaining portfolio was in arrears as of March 2000. In contrast, only 3 percent of the unit desa lending program’s portfolio was in arrears. The program continued to attract small savers after the crisis, with the total number of savings accounts reaching 24 million in 2000. Part of the reason surely lies in the lower vulnerability of micro-entrepreneurs and small farmers to risks related to the foreign exchange rate. (The rupiah fell from 3,500 per dollar to a nadir of 15,000 per dollar during 1997/98, before rising back to 7,500 after the political crisis abated). This reduced vulnerability of at least some poorer Indonesians probably contributed to the increased equality of income distribution after the crisis.[9] In effect, BRI’s operations with its poorest clients were massively supporting its unprofitable operations with its wealthier clients.

In conclusion, the 1997/98 crisis was a great misfortune for Indonesia. Unsurprisingly, just as a rise in income reduced poverty, a fall increased it. But the downturn did not alter in any fundamental way the success of the previous three decades. The increased education, knowledge, technology, and infrastructure that provided poor Indonesians in 2002 with better incomes, nutrition, education, and health than their parents had enjoyed were still in place.

[8] BPS, Statistics Indonesia, 2002.
[9] The BRI developments are reported in Patten et al., 2001.

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